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# FRBSF WEEKLY LETTER

October 28, 1988

## The Growing Presence of Japanese Banks

The growth of Japanese banking institutions in California has been extraordinary, with dramatic increases recorded in the assets, deposits, and commercial loans of Japanese-owned banks, agencies, and branches. In the last five years, the assets and market share of Japanese-owned institutions in California more than doubled. Although a series of acquisitions of existing banks accounts for much of the rapid expansion of Japanese-owned banks, a surge in international trade financing spurred growth at the agencies of Japanese banks.

Japanese banks dominate the list of the world's largest banks. Thus it is not surprising that many of these prominent Japanese banks maintain sizeable presences in the competitive California market. Last December, nine California banks, with combined assets of over \$25 billion, were subsidiaries of Japanese-owned banks. In addition, 24 agencies, with assets of \$48.7 billion, and two foreign branches of Japanese banks, with assets of \$2.2 billion, were operating in California, providing trade-related banking services.

### Business emphasis

A comparison of the Japanese-owned banks and domestic banks highlights significant differences in the two groups of banks. While there are considerable variations across both groups of banks in their marketing emphases and their portfolios, as a group, the Japanese-owned banks in California tend to rely more heavily on managed liabilities for funding and to hold a higher proportion of commercial loans in their asset portfolios.

In the aggregate, Japanese banks, with their traditional focus on business and trade, typically have had a relatively small retail deposit base and thus have relied heavily on certificates of deposit and such nondeposit sources of funds as Eurodollars. Purchased funds account for one-third of Japanese banks' liabilities, compared to less than 18

percent for domestic banks. Ordinarily, such dependence on "hot money" raises concerns about an institution's ability to fund itself during difficult times, but the financial strength of the parent institutions in Japan and their superior fund-raising capacity in international markets tend to allay such concerns about Japanese-owned banks in California. Moreover, contrary to the popular view, Japanese banks in California, as a group, are slightly better capitalized than their domestic counterparts. (Of course, the parent organization can be highly levered.)

Also, in keeping with Japanese banks' wholesale, commercial banking focus, commercial and business loans make up a large share of these banks' asset portfolios. At the end of 1987, business loans made up 29.9 percent of Japanese banks' asset portfolio in California. In contrast, business loans accounted for only 19.5 percent of domestic banks' assets.

However, Japanese banks recognize that one of the attractive features of the California banking market is the strong and growing retail market, which provides both a ready source of lower-cost household deposits and a strong demand for retail loans. Consequently, retail lending is growing in importance to Japanese banks. Japanese banks now make single family home loans and loans to individuals (including automobile loans, personal loans, and credit cards) in about equal volumes. Nonetheless, in the aggregate, retail loans still are a much smaller proportion of assets (under 20 percent) at the Japanese banks than at domestic banks (nearly 28 percent). But as Japanese banks become more active in local banking markets, these portfolio differences between Japanese-owned and domestic banks should narrow.

### California dreamin'

Japanese banks have made the California market an important target for several reasons, including

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a favorable location for international trade and strong economic factors. A majority of the U.S. trade with Japan passes through California on its way to the U.S. market. The surge in trade with Japan in recent years increased the need for overseas banking services—loans, payment facilities and deposits—on the part of Japanese firms doing business in California. Japanese banks responded to this need by enhancing their presence in California through the growth of their agencies and branches and through the acquisition of a number of existing domestic banks.

In addition to their trade-related customer base, Japanese bankers have also found the domestic California economy attractive in itself. Size, product diversity, and a record of rapid growth and economic stability provide favorable conditions for banking. Moreover, California's state-wide branching structure allows banks to generate a stable and relatively low cost retail deposit base and a strong base for middle market commercial lending.

Finally, the expansion of Japanese banks in California in recent years is associated with the liberalization of Japan's capital markets. Liberalized capital markets in Japan have freed funds for overseas investments, such as bank acquisitions, at a time when the value of the Yen relative to the dollar made U.S. investments attractive.

## **Market share**

The growth of the Japanese banks, agencies, and branches in California has been extraordinary. Measures of traditional market presence—assets, loans, deposits—all show the dramatic increases. Between 1982 and 1987 the assets of Japanese-owned institutions (banks, agencies and branches of foreign banks) in California have more than doubled, growing from \$34.6 billion to \$76.1 billion. Market share, which was 10.7 percent of the total assets of all banks, agencies and branches in 1982, rose to 21.7 percent by the end of 1987. The acquisition of Union Bank

by Bank of Tokyo's subsidiary, California First, which has already received regulatory approvals, will push that total market share to over 24 percent of total assets. And in commercial lending, which is their mainstay, Japanese banks captured nearly one-quarter of the market, not counting the impact on market share from the pending acquisition of Union Bank.

Japanese banks now own four of the top ten banks in the state: California First (6th largest, \$6.3 billion in assets as of 6-30-88), Sanwa Bank California (7th largest, \$5.9 billion), Bank of California (8th largest, \$4.9 billion), and Sumitomo Bank of California (10th largest, \$3.5 billion) and are in the process of acquiring the fifth largest (\$8.7 billion), Union Bank.

## **Shift in foreign ownership**

The expansion of Japanese banks clearly has changed California banking. However, the expanding presence of Japanese banks has had only a small impact on the market share of all foreign banking institutions in California. Over the last five years, foreign banks' market share increased only modestly, from 30.8 percent to 32.3 percent. Rather than wresting market share from domestic banks, Japanese banks essentially have replaced the British banks as the dominant foreign banking power in the California market.

## **Headstart**

One bonus of Japanese banks' recent expansion in the California market is that they now have a headstart over out-of-state banks in assembling and consolidating a statewide network of banks and branches. This will place them in an enviable position in 1991 when California is opened to out-of-state competitors. As the picture now stands, Japanese banks' investment in California should be well rewarded, both in terms of current profits and in future franchise value.

**Gary C. Zimmerman**  
Economist

**REGIONAL BANKING DATA**  
June 30, 1988  
(Not Seasonally Adjusted, Preliminary Data)

		DISTRICT	ALASKA	ARIZONA	CALIF	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH
ASSETS AND LIABILITIES -- \$ MILLION (ALL COMMERCIAL BANKS)											
ASSETS	TOTAL	415,343	4,641	27,421	289,626	12,331	7,213	11,259	19,408	10,657	32,785
	FOREIGN	42,139	1	N/A	39,871	865	N/A	N/A	0	109	1,293
	DOMESTIC	373,204	4,641	27,421	249,755	11,466	7,213	11,259	19,408	10,548	31,493
LOANS	TOTAL	288,205	2,429	19,691	202,370	7,280	4,727	8,433	12,234	7,112	23,929
	FOREIGN	34,531	1	N/A	33,199	629	N/A	N/A	36	N/A	666
	DOMESTIC	253,674	2,428	19,691	169,171	6,651	4,727	8,433	12,197	7,112	23,264
	REAL ESTATE	103,949	1,008	8,704	72,856	3,381	1,187	1,606	3,652	2,848	8,707
	COMMERCIAL	74,266	928	4,831	50,859	1,698	1,360	1,376	4,917	1,784	6,513
	CONSUMER	51,262	201	4,086	29,795	1,132	1,229	5,169	2,498	1,947	5,205
	AGRICULTURE	5,013	8	486	2,515	19	606	19	359	116	885
	INTERNATIONL	98	N/A	52	43	0	N/A	N/A	0	2	1
SECURITIES	TOTAL	41,788	1,184	3,554	22,845	2,514	1,536	1,784	3,292	1,713	3,367
	U.S.T.S.	13,697	772	1,493	6,425	1,015	623	596	976	467	1,329
	SECONDARY MKT.	14,909	198	430	10,773	490	413	390	725	656	832
	OTHER SEC.	13,182	213	1,631	5,647	1,009	500	797	1,591	589	1,206
LIABILITIES	TOTAL	391,991	4,202	25,685	274,595	11,523	6,705	10,576	18,173	9,868	30,665
	DOMESTIC	349,852	4,201	25,685	234,723	10,657	6,705	10,576	18,172	9,759	29,372
DEPOSITS	TOTAL	332,906	3,670	23,325	232,838	10,748	5,735	5,961	14,971	8,473	27,185
	FOREIGN	34,366	1	N/A	32,360	615	N/A	N/A	N/A	122	1,269
	DOMESTIC	298,540	3,669	23,325	200,478	10,133	5,735	5,961	14,971	8,351	25,915
	DEMAND	75,944	878	4,957	55,282	1,751	912	1,747	3,041	1,590	5,785
	TIME & SAV.	222,596	2,791	18,368	145,197	8,382	4,823	4,214	11,930	6,762	20,130
OTHER BORROWINGS		35,816	473	1,992	22,188	272	898	4,177	2,426	934	2,456
EQUITY CAPITAL		23,352	440	1,736	15,032	809	509	683	1,236	789	2,120
LOAN LOSS RESERVE		8,454	61	381	6,932	108	84	181	175	133	399
STANDBY LETTERS OF CREDIT		32,571	26	711	28,741	332	105	168	548	298	1,643
LOAN COMMITMENTS		133,421	361	5,693	107,600	3,350	820	1,349	3,899	1,524	8,825
LOANS SOLD		104,369	38	282	103,438	66	37	51	127	68	262

<b>ASSET QUALITY -- PERCENT OF LOANS (LARGE COMMERCIAL BANKS)</b>										
LOAN LOSS RESERVE (ALL BANKS)	2.93	2.51	1.93	3.43	1.48	1.78	2.15	1.43	1.88	1.67
NET CHARGEOFFS, TOTAL	1.02	9.78	1.05	0.89	0.18	0.62	1.97	0.98	1.16	1.15
REAL ESTATE	0.39	19.70	0.43	0.15	0.04	0.29	0.37	0.40	0.54	0.26
COMMERCIAL	0.76	4.13	0.60	0.61	0.19	0.95	2.11	0.79	1.61	1.69
CONSUMER	1.75	0.79	1.90	1.90	0.28	0.66	2.46	1.16	0.79	1.32
AGRICULTURE	0.28	N/A	0.86	-26	0.97	0.85	N/A	1.51	0.68	0.77
PAST DUE & NONACCRUAL, TOTAL	5.56	21.20	6.50	5.84	2.20	2.83	3.89	3.27	4.63	4.37
REAL ESTATE	5.43	34.30	9.59	4.64	1.87	4.19	4.34	5.77	7.02	5.59
COMMERCIAL	5.11	16.40	6.44	5.26	2.98	2.63	5.22	2.45	3.50	4.55
CONSUMER	2.54	2.30	1.87	2.67	2.12	1.83	3.58	1.65	2.04	2.11
AGRICULTURE	12.90	4.73	5.41	19.00	26.90	4.24	0.79	7.09	5.80	6.05

EARNINGS AND RETURNS -- \$ MILLION (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	20,869	201	1,262	14,641	581	348	713	892	541	1,690
	INTEREST	17,470	170	1,093	12,079	510	311	629	776	478	1,425
	FEES & CHARGES	996	9	69	685	16	20	23	49	29	96
EXPENSES	TOTAL	18,504	230	1,178	12,962	487	304	577	759	504	1,505
	INTEREST	9,136	105	598	6,351	273	169	263	391	254	732
	SALARIES	3,863	46	255	2,748	109	53	83	162	80	328
	LOAN LOSS PROV.	1,203	14	90	837	13	14	72	35	47	84
	OTHER	4,302	65	235	3,026	92	69	159	172	123	361
INCOME BEFORE TAXES		2,356	-29	83	1,674	94	45	136	131	37	185
TAXES		854	1	17	656	29	13	41	38	9	48
NET INCOME		1,630	-29	70	1,110	65	31	95	94	28	166
ROA (%)		0.80	-1.30	0.56	0.77	1.06	0.87	1.73	1.03	0.54	1.02
ROE (%)		15.50	-13.00	8.94	16.50	16.40	13.50	25.70	17.10	9.37	17.80

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MARKET SHARE STATISTICS  
PERCENT OF TOTAL DEPOSITS, FOR AUGUST 1988, BY REGION

DEPOSIT TYPE	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII			IDAHO			NEVADA			OREGON			UTAH			WASH		
	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	46	50	4	71	10	19	53	43	4	42	55	3	65	30	6	86	11	4	64	33	4	66	29	5	58	33	9	54	39	7
DEMAND	94	4	2	98	1	1	93	4	3	93	5	2	94	3	3	99	1	0	100	0	0	96	2	3	91	6	3	95	4	1
NOW	60	34	6	49	16	35	63	29	8	56	39	5	72	24	4	86	7	6	79	17	4	77	18	5	68	22	10	66	22	12
SAVINGS & MMDA	57	34	8	53	9	38	64	28	7	55	38	7	60	30	11	86	9	5	67	27	6	69	22	9	60	19	20	54	32	15
SMALL TIME	26	72	3	71	19	10	40	58	2	20	78	2	40	57	3	81	17	2	35	63	3	49	48	3	41	54	5	40	57	3
LARGE TIME	33	66	1	91	7	2	38	61	1	28	71	1	81	17	2	84	11	4	54	46	0	64	32	3	65	33	3	50	49	1

CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND MUTUAL SAVINGS BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

INTEREST RATES ON DEPOSITS AND LOANS (%)

TYPE OF ACCOUNT OR LOAN	DATE	US	DISTRICT	ARIZONA	CALIF	HAWAII	IDAHO	OREGON	UTAH	WASH
MONEY MARKET DEPOSIT ACCOUNTS	JUN88	5.45	5.19	5.04	5.24	5.18	5.07	4.85	5.60	5.08
	JUL88	5.49	5.22	5.11	5.28	5.18	5.11	4.86	5.65	5.08
	AUG88	5.60	5.32	5.14	5.34	5.26	5.19	4.92	5.88	5.08
6-MONTH CERTIFICATES	JUN88	6.82	6.24	6.10	6.26	6.04	6.49	6.50	6.57	6.18
	JUL88	6.99	6.34	6.16	6.35	6.11	6.76	6.50	6.71	6.36
	AUG88	7.26	6.62	6.32	6.54	6.34	7.20	6.81	7.30	6.46
2-1/2 YEAR CERTIFICATES	JUN88	7.79	7.48	7.45	7.21	7.64	7.62	7.75	7.38	7.29
	JUL88	7.90	7.53	7.58	7.23	7.64	7.84	7.84	7.38	7.24
	AUG88	8.11	7.70	7.85	7.47	7.72	7.97	8.09	7.74	7.30
COMMERCIAL LOANS, SHORT-TERM	AUG88	9.75	9.62	10.92	9.45	9.80	11.24	9.61	9.22	10.39
AVERAGE MATURITY (DAYS)		49	49	108	29	127	107	114	143	80
COMMERCIAL LOANS, LONG-TERM	AUG88	10.44	10.86	10.73	10.51	10.78	11.19	N/A	11.69	11.27
AVERAGE MATURITY (MONTHS)		44	47	30	28	16	81	N/A	63	49
CONSTRUCTION LOANS	AUG88	10.54	10.73	11.43	10.79	N/A	N/A	N/A	N/A	9.62
AVERAGE MATURITY (MONTHS)		11	12	N/A	12	N/A	N/A	N/A	N/A	11
LOANS TO FARMERS	AUG88	11.50	10.25	8.66	10.48	8.28	11.52	9.69	11.20	10.67
AVERAGE MATURITY (MONTHS)		7	9	1	8	20	5	11	5	6
CONSUMER LOANS, AUTOMOBILE	AUG88	10.93	11.52	N/A	11.63	N/A	12.00	10.11	11.50	12.62
CONSUMER LOANS, PERSONAL	AUG88	14.81	16.42	N/A	19.17	N/A	12.00	14.38	18.00	17.10
CONSUMER LOANS, CREDIT CARDS	AUG88	17.79	17.91	N/A	19.12	N/A	N/A	19.24	18.00	15.75

SOURCES: SURVEY OF TERMS OF BANK LENDING & TERMS OF CONSUMER CREDIT; MOST COMMON INTEREST RATES ON SELECTED ACCOUNTS